

VZCZCXRO1750  
PP RUEHCD RUEHGD RUEHHO RUEHMC RUEHNG RUEHNL RUEHRD RUEHRS RUEHTM  
DE RUEHME #7032/01 3551940  
ZNR UUUUU ZZH  
P 211940Z DEC 06  
FM AMEMBASSY MEXICO  
TO RUEHC/SECSTATE WASHDC PRIORITY 4673  
INFO RUEHXC/ALL US CONSULATES IN MEXICO COLLECTIVE PRIORITY  
RUEHBJ/AMEMBASSY BEIJING PRIORITY 0377  
RUEHKO/AMEMBASSY TOKYO PRIORITY 0443  
RUCPDO/DEPT OF COMMERCE WASHDC PRIORITY  
RUEHRC/DEPT OF AGRICULTURE WASHDC PRIORITY  
RHEBAAA/DEPT OF ENERGY WASHINGTON DC PRIORITY  
RUEHC/DEPT OF LABOR WASHDC PRIORITY  
RUEATRS/DEPT OF TREASURY WASHDC PRIORITY  
RHMFIUU/CDR USSOUTHCOM MIAMI FL PRIORITY  
RHMFIUU/CDR USNORTHCOM PRIORITY  
RHEHNSC/NSC WASHDC PRIORITY

UNCLAS SECTION 01 OF 06 MEXICO 007032

SIPDIS

SIPDIS

STATE FOR A/S SHANNON  
STATE FOR WHA/MEX, WHA/EPSC, EB/IFD/OMA  
STATE FOR EB/ESC MCMANUS AND IZZO  
USDOC FOR 4320/ITA/MAC/WH/ONAFITA/ARUDMAN  
USDOC FOR ITS/TD/ENERGY DIVISION  
TREASURY FOR IA (ALICE FAIBISHENKO)  
DOE FOR INTERNATIONAL AFFAIRS KDEUTSCH AND SLADISLAW  
STATE PASS TO USTR (EISSENSTAT/MELLE)  
STATE PASS TO FEDERAL RESERVE (CARLOS ARTETA)  
NSC FOR DAN FISK

E.O. 12958: N/A

TAGS: [ECON](#) [ECPS](#) [ELAB](#) [EFIN](#) [PGOV](#) [PREL](#) [MX](#)

SUBJECT: MEXICO ECONOMIC NOTES, DECEMBER 14 - DECEMBER 20  
2006

#### Summary

1. (U) The revenue portion of the budget was first approved by the Chamber of Deputies and then the Senate though the Senate rejected the specific provision regarding the soft drink tax. However, this will probably not prevent the elimination of the discriminatory 20 percent tax on beverages sweetened with anything other than cane sugar. The Senate also modified the portion on tax deductions for new autos. Finance Secretary Augustin Carstens defended the new taxes, saying they are necessary to avoid future fiscal deficits. Secretary of Communication and Transportation Luis Tellez

SIPDIS

announced that the majority of SCT's budget will go to infrastructure development. More fixed line phone providers have agreed to join the calling party pays program. Cofetel has announced advances bringing Mexico closer to services allowed for in the Convergence Accord. Public debate continues over a possible third television channel in Mexico. China has surpassed Mexico as America's second largest trading partner. Japanese companies are looking to increase investments in Mexico. The high level appointment of a relative of the teachers' union president has drawn criticism. The peso fell as remittances from the U.S. decreased. End Summary.

#### Budget Battles

#### Chamber of Deputies Approves Revenue Law

2. (U) The lower house of Congress approved the income side

of the 2007 federal budget December 18, unanimously adopting a MXP 2.264 trillion (about USD 208 billion) package that included a new 5 percent tax on soft drinks and a gradually escalating tobacco tax. The Chamber of Deputies approved the same government income figure sent up by its Finance Committee. This amount was MXP 30.7 billion (USD 2.8 billion) more than that called for in President Felipe Calderon's proposed budget. The increase could facilitate the restoration of education funding that Calderon had sought to cut. Income and sales taxes will account for about MXP 1.5 trillion of the revenue flowing into the government treasury next year, including from taxes on gasoline, alcoholic beverages, tobacco products and vehicle ownership. Another MXP 700 billion will come from non-tax sources, mostly social security premiums and profits from PEMEX. The PEMEX income estimate is based on a barrel price of USD 42.80. The bill passed 425 to 0 with one abstention. The unanimous vote came 17 days after the top two political parties in the Congress - PAN and PRD - came to blows on the Chamber floor. "This shows that the (current) legislature has the will to arrive at agreements that the country needs," said Chamber president Jorge Zermeno, a PAN member.

#### Senate Rejects Soft-Drink Tax, Likely to Comply with WTO

-----

13. (U) The Senate approved the Revenue Bill December 20 but rejected the 5 percent tax on soft drinks. PRI and PRD senators assembled 73 votes versus the PAN's 55 to defeat the proposal. The beverage tax now returns to the lower chamber, where deputies have three options 1) negotiate with the Senate to keep the 5 percent tax (unlikely); 2) negotiate with the Senate a reduced rate of 2.5 or 3 percent, or 3) eliminate the proposed tax altogether. The second and third options would mean that additional revenue would have to be found elsewhere. A top staffer of the lower House Finance

MEXICO 00007032 002 OF 006

Committee assured Econoffs that, regardless of the final level of the soft drink tax, the discriminatory 20 percent tax on beverages sweetened with anything other than cane sugar (e.g., high fructose corn syrup or beet sugar) would certainly be repealed, in keeping with Mexico's WTO obligations. In fact, the Senate hold on the beverage tax provision made no mention of the elimination of the discriminatory 20 percent tax, indicating that at present this is not a point of contention between the two Chambers. This could change during negotiations, but right now the outlook is good.

#### Senate Modifies New Tax Deduction Limits Amid Complaints for Auto Industry

-----

14. (U) As part of their revisions to the revenue bill, the Senate modified the provision that decreased the value limit for which income tax deductions could be claimed for new car purchases. The original modification, included by the Secretariat of Finance in the 2007 budget, lowered the

SIPDIS

deduction restriction to cars valued at more than 150,000 MXP, from the previous level of 300,000 MXP. The Senate plan raised the restriction limit to vehicles valued at more than 175,000. Last week, the Presidents of the Mexican Dealers Association (AMDA) and the Mexican Automobile Industry Association (AMIA) met with Jorge Estefan, Chair of the Finance Committee of the Chamber of Deputies to express concerns regarding the restriction on income tax deductions for new vehicle purchases. AMIA and AMDA reported 53 percent of the vehicles sold in Mexico are valued within the 150,000 to 300,000 MXP range and that the average value of domestically produced vehicles is 150,000 MXP since more expensive cars are usually imported. The organizations alleged that the provision would result in diminished demand and necessitate a 20 percent decrease in national production.

Carstens: Reform or Deficit

15. (U) Speaking at a conference in Mexico City, Finance Secretary Agustin Carstens said 2006 was an "extraordinary"

SIPDIS

economic year because oil prices exceeded budget estimates. He stressed that new taxes and better tax collection are needed to make up for lost oil revenue, and waning demand for Mexican exports as the U.S. economy slows. Carstens is seeking support for new taxes and better collection after industry groups have said they would block such measures. "In Latin America, only Guatemala has lower tax revenue than Mexico," Carstens said. "It is going to be a priority of this administration to make an effort to increase tax revenue in order to reduce our vulnerability on oil revenue and establish a base for development." Carstens said the 2007 budget's 50 percent increase in security spending is justified because it helps lure investment, which boosts employment. Mexico's need to diversify away from oil revenue will increase during 2007 as prices for the country's crude mix falls and production declines. The country's 2006 budget plan estimated Mexico's crude mix would average USD 36 per barrel. The average for the year will probably reach USD 53 per barrel, Carstens said. The 2007 budgets estimates an average Mexican crude price of USD 5.5 lower than USD 48 suggested by futures contracts, he said. The government expects oil revenue to drop to 7.3 percent of GDP in 2012 from 8.3 percent in 2007. Carstens has also stated that the proposed taxes for 2007 will not have a recessionary impact on the economy since the additional collection, is marginal compared to the MXP 2.3 billion budget. Carstens asserted that without reforms, the fiscal deficit could reach 3 percent of GDP by 2012. The recently ratified Under

MEXICO 00007032 003 OF 006

Secretary of Income, Fernando Sanchez Ugarte, acknowledged

SIPDIS

that the tax system in Mexico is complicated and that it has to be simplified. The Mexican Institute of Finance Executives argued that the tax proposals planned by the Executive branch only target the same honest taxpayers and have a negative impact on investment and creation of jobs.

Infrastructure: Priority for Secretariat of Communications and Transportation

16. (U) Secretary of Communications and Transportation Luis Tellez announced that most of the 2007 Secretariat of Communications and Transportation (SCT) budget will be channeled to infrastructure projects. Of the MXP 27.56 billion allocated to the Secretariat, 68.5 percent will be used for the construction and modernization of 927.3 km of highways. Under Secretary of Infrastructure, Oscar de Buen, said that the public investment will be complemented by investment from private sources with approximately MXP 16.34 billion will be assigned to either private sector concessions or the service lending scheme Proyecto Para Prestaciones de Servicio (PPS). Under Secretary of Transportation, Manuel Rodriguez Arregui, disregarded rumors of the construction of a new international airport terminal. He says that with the expansion of Mexico City's airport, the existing airports are enough to meet demand and that Transportation's priorities will be Punta Colonet, the Suburban Train, Trans-seismic Corridor, and the renewal of trucks. Tellez confirmed that he is in talks with the U.S. on opening the border to trucking.

Telecommunications

## Calling Party Pays

---

17. (U) Alestra and Maxcom decided to join Long Distance Calling Party Pays beginning o/a December 16. According to the agreement reached by the companies, interconnection fees will be gradually reduced over four years, from 1.34 pesos per minute in 2007, to 1.21 in 2008, 1.09 in 2009, and 1 peso per minute in 2010. In return, the companies will withdraw the injunctions they had filed against the plan, which went into effect on November 4, 2006. It is expected that Telefonica, as well as Avantel-Axtel, will also reach an agreement to join the scheme soon. Marcatel has announced that for now, it won't subscribe to any agreement. The fixed line companies opposed the plan because they claimed the interconnection fees to be charged by cell phone providers were too high.

## Convergence Agreement

---

18. (U) Two Cofetel announcements this week brought Mexico closer to triple play services under the Convergence Accord published in October 2006. First, Cofetel issued a resolution on rules of number portability. Number portability should be implemented during the second half of 2007 by Telmex, and at the end of the year by other companies, including Telcel. Implementation will be based on the consultation of a common database by telephone operators. It is expected that the industry will have to invest around USD 300 million. Jose Luis Peralta, one of Cofetel's commissioners, explained that the consumer might have to pay a fee to keep the number when switching companies. However,

MEXICO 00007032 004 OF 006

he explained that companies won't charge any fee to recover the investment made. Telmex will have to implement the number portability before any other company in order to comply with the Convergence Agreement. Telmex is also required to comply with rules on interconnection and interoperability, though Cofetel is not expected to meet the deadline for issuing guidelines on interconnection. Cofetel also announced that it has found no legal grounds to oblige Telmex to pay for the right to provide video services. Former Secretary of Finance Francisco Gil Diaz proposed during the debate over the Convergence Accord that Telmex should pay for this right in order for the government to benefit from the profits Telmex will make once its concession is modified. One of Cofetel's commissioners, Eduardo Ruiz Vega, said that Cofetel sent its opinion to the new Secretariat of Finance, which will now have to determine

SIPDIS

whether Telmex has to pay or not.

## Debate over Third Television Channel

---

19. (U) The debate over whether Mexico should open the television market to a third channel continued this week. The new head of the Secretariat of Communications and Transportation, Luis Tellez, sent mixed signals as media reported he used a secret meeting to order Cofetel to start looking into the steps needed to allow a third channel, and to work with the SCT to take on duopolists Televisa and TV Azteca. Cofetel commissioners denied the report. In his first press conference as minister of the SCT, Tellez told reporters that Calderon had not promised to grant a license for a third TV company. He explained that in his 100 commitments, Calderon promised to bid TV and radio frequencies in different cities, but he didn't talk about a third broadcasting company. However, Tellez said that the Mexican government would be willing to authorize greater "foreign" participation in the telecommunications sector as long as the U.S. did the same for Mexican companies. During

the conference, Del Villar asserted that the basis for telecom public policy is: "competition, coverage, and convergence". The debate also reached the Senate, where on December 15 Senator Javier Orozco, a member of the Communications and Transportation Committee, said that U.S. company General Electric's participation in Palmas 26 (a collaboration between GE and Mexican Isaac Saba's Grupo Xtra to enter the Mexican television market) should be strictly inspected. On December 18, several senators called for more competition in the sector, saying that there is room for a third company in order to eliminate the existing duopoly. PRI Senator, Rafael Alejandro Moreno, said that to authorize a third company could mean an exorbitant increase in money spent on political campaigns. For its part, the Secretary of Governance commented that all talk of a third channel is pure speculation at this point, saying "We must allow time to know what kinds of opportunities really exist for a new channel."

-----  
All About Asia  
-----

China Passes Mexico in U.S. Trades  
-----

¶10. (U) China passed Mexico as the second-largest U.S. trading partner in the first 10 months of this year. China's rise indicates a relative decline for Mexico. China's trade with the United States is on pace to quadruple from the total in 1998, while Mexico's trade with the U.S. is up less than 50% over that same time period.

MEXICO 00007032 005 OF 006

Japan Looks for Mexican Investments  
-----

¶11. (U) Thanks to the economic association agreement signed in 2005, Mexico will receive more Japanese investment. Honda is evaluating the possibility of expanding its operations in Mexico. According to the Mexican branch of the Japanese External Trade Organization (Jetro), several Japanese companies are currently performing feasibility studies to decide whether to invest more in the country. After the agreement was signed, Nissan invested USD 800 million in its Aguascalientes plant, Bridgestone invested USD 220 million in its Monterrey factory, and Toyota channeled USD 37 million to expand its plant in Baja California. Jetro said Japanese are waiting to see what Calderon's industrial promotion policy will be. Jetro also asserted that with the strengthening and deepening of NAFTA, Japanese companies tend to see the region as an integrated market when they analyze the future of their investments. Jetro believes that Mexico could be capable of attracting research and development centers, but only if the country improves its education system.

-----  
New Housing Plan to Help Poorest Workers  
-----

¶12. (U) On Monday, Calderon announced that the government's principle housing assistance program will give top priority to the poorest workers. "Our housing program will have an eminently social character," Calderon said. "We want to put a large subsidy program into effect so that the families that earn less than three times the minimum daily salary will be able to build a house, improve their existing home, or acquire an apartment." Calderon said his administration would seek to double the annual number of housing credits delivered through housing program Infonavit, setting a goal of 6 million credits for his six-year administration. That number, however, would include participation from the private sector. "By the year 2030, we have to build as many housing units as were built in the entire 20th century," he said.

-----  
Teacher's Union Gains Friend in High Place  
-----

-----  
¶13. (U) The National Teacher's Union (SNTE) has been the focus of considerable attention recently because of their alleged influence on Mexico's education policy. The most recent accusations have to do with the appointment of Jose Francisco Gonzalez Sanchez as Undersecretary for Basic Education. Gonzalez Sanchez is the son-in-law of SNTE president Elba Esther Gordillo, who in her own right has been the focus of attention due to the alleged wealth she has amassed while serving as leader of the organization. While Gonzalez Sanchez does have background in Basic Education, journalist have noted that he has in the past acted as the political link between Calderon and his mother-in-law.

-----  
Peso Falls as Remittances Ease During Holiday Period  
-----

¶14. (U) The peso had one of the sharpest weekly declines falling 0.4 percent to 10.8225 pesos per U.S. dollar on December 18. Earlier, it weakened as much as 0.5 percent, the biggest one-day decline since Dec. 7. The decrease is partly due to slowing inflows of dollars from Mexicans working abroad. Remittances dropped after their sharp rise during the first half of the month helped fuel a 1.4 percent increase in the peso. (Comment: Remittances for the month were likely sent earlier than usual to be available for use

MEXICO 00007032 006 OF 006

during the holiday season. End Comment.) During the first nine months of 2006, remittance flows had spurred a surplus of USD 628 million in Mexico's current, reversing a deficit in 2005. Mexico's currency was also driven lower on December 18 by declining prices for oil. Oil dropped 1.9 percent to USD 62.21 per barrel as warmer-than-normal weather in the U.S. curbed heating fuel consumption. The yield on the Mexico's 8 percent peso bond due in December 2015 rose 3 bond points to 7.55 percent, its highest since Dec. 5. The price, which moves inversely to the yield, fell 0.19 centavos to 102.93 centavos per peso.

Visit Mexico City's Classified Web Site at  
<http://www.state.sgov.gov/p/wha/mexicocity>  
BASSETT